74

Office-Supreme Court, U. S.
FILED
FEB 27 1951
CHARLES ELMORE CROPLEY

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1950

No. 581

ROYAL INDEMNITY COMPANY, A CORPORATION,
Petitioner,

vs.

UNITED STATES OF AMERICA

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

ARTHUR W. GRAFTON,
CORNELIUS W. GRAFTON,
LOUIS LUSKY,
Counsel for Petitioner.

CHARLES I. DAWSON,
Of Counsel.

INDEX

	Page
Opinion below	1
Jurisdiction	1
Questions presented	2
Statutes involved	3
Statement	4
Reasons for granting the writ	7
Conclusion	15

CITATIONS

Cases:

American Textile Woolen Co. v. *Commissioner*, 23 B.T.A. 670, 68 F. (2d) 820 (1934), cert. denied, 293 U. S. 558 (1934)	6, 10
Noel v. *Baskin*, 131 F. (2d) 231 (App. D. C. 1942)	11, 12, 13
Page v. *Haverty*, 129 F. (2d) 512 (C.C.A. 5th, 1942)	9
Royal Indemnity Co. v. *United States*, 120 F. (2d) 136 (1941), cert. denied, 315 U. S. 797 (1942)	7
Signal Oil & Gas Co. v. *United States*, 125 F. (2d) 476 (C.C.A. 9th, 1942)	9

Statutes:

Revenue Act of 1918, Sec. 240 (40 Stat. 1057, 1081)	3, 4, 6, 10
Revenue Act of 1918, Sec. 250 (40 Stat. 1057, 1083)	4, 12
Revenue Act of 1924, Sec. 277 (43 Stat. 253, 299)	4, 12

Miscellaneous:

Rules of the United States Supreme Court, Rule 38(5)(b)	7
American Law Institute, Restatement of Judgments, Sec. 96, Comment a	11
Annotation, 1 A.L.R. (2d) 1445 (1948)	13

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1950

No. 581

ROYAL INDEMNITY COMPANY, A CORPORATION,
Petitioner,

vs.

UNITED STATES OF AMERICA

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

Royal Indemnity Company, a corporation, prays that a writ of certiorari issue to review the judgment of the United State Court of Claims entered in this case.

Opinion Below

The special findings of fact and opinion of the Court of Claims (R. 8-32) are reported at 92 F. Supp. 1003.

Jurisdiction

The judgment of the Court of Claims was entered on October 2, 1950 (R. 32). A motion for new trial, timely made, was denied December 5, 1950 (R. 33). The jurisdiction of this Court is invoked under 28 U.S.C., Section 1255 (1).

Questions Presented

A wholly-owned subsidiary filed its separate income and profits tax return for the calendar year 1918, indicating that it owed taxes in the amount of $129,364.93. Thereafter the Commissioner of Internal Revenue determined that said subsidiary was required to file a consolidated return with its parent corporation. The consolidated return was filed. The Commissioner then determined that, by reason of an agreement between the corporations, the entire consolidated tax liability should be assessed against the parent. The parent appealed from this determination and the Board of Tax Appeals upheld the Commissioner, the subsidiary not being a party to the appeal. The Sixth Circuit Court of Appeals affirmed, and this Court denied certiorari. The Government then collected from the *subsidiary's* surety the unpaid balance of the $129,364.93 tax indicated by the subsidiary's original separate return.

The questions are:

(1) Did the Court of Claims err in holding that the said subsidiary (or petitioner surety company, as its subrogee) is bound by the judgment in the earlier case to which it was not a party, and that it therefore is not entitled to a hearing on the question whether taxes paid under the separate return were erroneously collected?

(2) If the subsidiary is bound by the judgment in the earlier case to which it was not a party, did the Court of Claims err in its holding that said judgment established the taxability of the subsidiary?

(3) Did the Court of Claims err in holding that a 1919 waiver of the statute of limitations on collection of the tax was effective in perpetuity, or at least until 1936 when the United States brought suit to collect the tax?

(4) Did the Court of Claims err in holding that the

United States could legally collect a tax from the subsidiary, based on a separate assessment, after successfully establishing that a consolidated assessment was required, and after obtaining judgment against the parent for the entire consolidated tax?

(5) Did the Court of Claims err in holding that the rights of petitioner, as surety on the subsidiary's bond, can be no greater than those of the subsidiary?

(6) Did the Court of Claims err in failing to credit the subsidiary for the $30,000.00 which it contributed toward payment of the parent's tax liability?

Statutes Involved

Revenue Act of 1918, Sec. 240 (40 Stat. 1057, 1081):

> "(a) That corporations which are affiliated within the meaning of this section shall, under regulations to be prescribed by the Commissioner, with the approval of the Secretary, make a consolidated return of net income and invested capital * * *, and the taxes thereunder shall be computed and determined upon the basis of such return:
>
> * * * * * * *
>
> "In any case in which a tax is assessed upon the basis of a consolidated return, the total tax shall be computed in the first instance as a unit and shall then be assessed upon the respective affiliated corporations in such proportions as may be agreed upon among them, or, in the absence of any such agreement, then on the basis of the net income properly assignable to each.
>
> "(b) For the purpose of this section two or more domestic corporations shall be deemed to be affiliated
>
> "(1) if one corporation owns directly or controls * * * substantially all the stock of the other or others, * * *."

Revenue Act of 1918, Sec. 250 (40 Stat. 1057, 1083):

"(d) Except in the case of false or fraudulent returns with intent to evade the tax, the amount of tax due under any return shall be determined and assessed by the Commissioner within five years after the return was due or was made, and no suit or proceeding for the collection of any tax shall be begun after the expiration of five years after the date when the return was due or was made. * * *"

Revenue Act of 1924, Sec. 277 (43 Stat. 253, 299):

"(a) Except as provided in section 278 and in subdivision (b) of section 274 and in subdivision (b) of section 279—

* * * * * * *

"(2) The amount of income, excess-profits, and war-profits taxes imposed by * * * the Revenue Act of 1918, and by any such Act as amended, shall be assessed within five years after the return was filed, and no proceeding in court for the collection of such taxes shall be begun after the expiration of such period."

Statement

During the calendar year 1918, Louisville Woolen Mills, a corporation (hereinafter called "Louisville"), was a wholly-owned subsidiary of American Textile Woolen Company (hereinafter called "American"). American had other subsidiaries but their existence is immaterial to the present issues. (R. 9).

Under Section 240(a) of the Revenue Act of 1918, *supra*, American and its subsidiaries, including Louisville, were required to file a consolidated income and profits tax return. However, perhaps in ignorance of this statutory provision—which was enacted in the spring of 1919, only a few days before the due date of the 1918 return—Louisville on

March 15, 1919, filed a separate return for itself alone. (R. 10, 11, 29.)

This return indicated a tax liability of $129,364.93, which Louisville elected to pay in quarterly installments as permitted by law. It paid the first three installments, totaling $97,023.69. On December 20, 1919, Louisville filed a claim for abatement of the fourth installment of $32,341.24, on grounds not here material. In connection with the abatement claim, Louisville gave the Collector its bond, with Royal Indemnity Company (petitioner herein) as surety. This bond guaranteed the collectibility of said $32,341.24, or so much thereof as the Commissioner of Internal Revenue should "find from his rulings to be due," with interest. (R. 10-11.)

On October 26, 1920, the Commissioner advised American that a consolidated return for 1918 should have been filed. This decision was and is accepted by the parties as correct, and is not now in issue. Accordingly, on February 12, 1921, American filed a consolidated return for itself and its subsidiaries, indicating a total tax liability of $351,034.14. Various proceedings were had, and on May 21, 1924, the Commissioner mailed to American an audit letter proposing a consolidated tax of $483,217.93. An administrative appeal resulted in the lowering of this figure to $429,539.94. On October 7, 1925, the Commissioner mailed to the "American Textile Woolen Company and Subsidiaries, Sweetwater, Tennessee" a so-called 60-day letter proposing assessment of a consolidated tax in that amount. (R. 11-17.)

As found by the Court of Claims (R. 17):

> "15. On December 5, 1925, American filed an appeal with the Board of Tax Appeals from the deficiency asserted by the Commissioner in his letter of October 7, 1925. Later, by order of January 14, 1926, on motion of American and with the consent of the Commissioner, the four subsidiaries were brought in as parties to the

> appeal by amendment. Later, and prior to the hearing on appeal, by agreement of American and the Commissioner and with the concurrence of the Board, the subsidiaries were eliminated by appropriate order upon the ground that the deficiency letter of October 7, 1925, was not a statutory notice to the said subsidiaries of the respondent's determination of a deficiency against them."

The only question at issue before the Board of Tax Appeals was whether American and its subsidiaries had made an agreement among themselves for assessment of the entire consolidated tax against American. The Commissioner contended that such an agreement existed and that, as provided by Section 240(a), the entire tax had to be assessed against American. The Commissioner prevailed, the Board holding on June 12, 1931, that the entire consolidated tax was assessable against American. 23 B.T.A. 670. The Sixth Circuit Court of Appeals affirmed, 68 F. (2d) 820 (1934) and this Court denied certiorari, 293 U. S. 558 (1934). (R. 18-22.)

In spite of the said decision that American was liable for the entire consolidated tax, the Commissioner took the position that Louisville was also liable for the tax of $129,364.93, which was indicated by its separate 1918 return. On August 23, 1932, he rejected Louisville's pending claim for abatement of the last quarterly installment of this tax, and thereafter he made demand on Louisville and its surety for the unpaid quarterly installment of $32,341.24, with interest. (R. 23-24.)

Louisville was by then insolvent, and petitioner, as its surety, undertook to defend the claim. Petitioner refused to pay, on the ground that the B.T.A. decision holding American liable for the *entire* consolidated tax had the effect of exonerating Louisville from *any* liability therefor. On August 12, 1936, the United States sued petitioner as

surety on the bond, in the United States District Court. (R. 24.)

Petitioner sought to set up the defense that Louisville was not liable for the tax. The court refused to entertain this defense, and rendered judgment against petitioner for $32,341.24 plus interest. The Sixth Circuit Court of Appeals affirmed, *Royal Indemnity Co.* v. *United States*, 120 F. (2d) 136 (1941), saying (at p. 138):

> "The liability for the tax as tax may have been terminated, though this we do not decide, or, as in United States v. John Barth Co., 279 U. S. 370, 49 S. Ct. 366, 367, 73 L.Ed. 743, collection may become impossible because of the running of time, but this has no bearing upon the obligation of the surety upon the bond."

The court held that, the bond having been given to guarantee the *collectibility* of the tax, and being conditioned only on the Commissioner's determination that a tax was due—not on a *correct* determination—the surety was obligated to pay. This Court denied certiorari, 315 U.S. 797 (1942). Petitioner then satisfied the judgment in full by payment of $93,545.80 to the United States. (R. 24.)

On May 15, 1943, petitioner as subrogee of Louisville's rights filed a timely claim for refund of said $93,545.80, with interest. After rejection of the claim, this action was timely brought in the Court of Claims to recover the refund. The Court of Claims entered judgment for the defendant. (R. 24, 32.)

Reasons for Granting the Writ

1. The decision below is not only wrong, but departs so far from the accepted and usual course of judicial proceedings as to call for an exercise of this Court's power of supervision. (See Rule 38(5)(b).)

Incredible as it seems, the Court of Claims has ruled that

it is possible for the United States to collect (and keep) a tax without granting the taxpayer a hearing on its legality, even though the taxpayer has neither waived his rights nor slept on them. That is the shocking and extraordinary result which will ensue unless this Court takes jurisdiction and reverses the judgment below.

Louisville had a meritorious defense to the Government's claim for 1918 taxes, namely, that the entire consolidated tax had been assumed by American. The Government itself, in resisting American's appeal, had successfully contended for this position before the Board of Tax Appeals. The B.T.A. decision was appealed to the highest court possible, and cannot be questioned by the Government since it was a party to that case.

Louisville endeavored to join in that earlier case in order to obtain there a hearing on its tax liability. Louisville was dismissed out of the case, however, because the Government had failed to give it the statutory notice which was a jurisdictional prerequisite to review by the B.T.A.

Louisville (*i.e.*, petitioner as its surety) then resisted collection in the District Court. Again no hearing could be had on the merits of the tax liability, because the Government was entitled to collect without regard to the correctness of the assessment, leaving the taxpayer to test out the merits in a refund suit. The District Court so held, and its decision was appealed to the highest court possible.

Petitioner then paid the tax and brought this suit for refund. For a third time, it has now been ruled that no hearing can be had on the merits of the tax. The court below recognized that the merits were not foreclosed by the decision in the suit on the bond. It held, however, that the decision in the B.T.A. proceeding—to which Louisville was not a party—had rejected Louisville's claim on the merits.

The circle is now complete. Louisville could not contest

the tax before the B.T.A. because the Government had made it impossible for Louisville to become a party. Louisville could not contest the tax before the District Court because the merits were not open in a suit on a collection bond. And Louisville cannot contest the tax in this case, so the Court of Claims has held, because the B.T.A. decision "cannot be questioned here."

The opinion below does not explain how Louisville can be bound by a decision in a case to which it was not a party. Perhaps it was thought that Louisville was bound because American, its parent corporation, was a party. But it is well settled that the distinct corporate personality of affiliated corporations will be respected unless the device of separate incorporation has been used to defeat the ends of justice. *Page* v. *Haverty,* 129 F. (2d) 512 (C.C.A. 5th 1942). *Signal Oil & Gas Co.* v. *United States,* 125 F. (2d) 476 (C.C.A. 9th 1942). And no hint of fraud, or even of sharp practice, appears in the record. Indeed, the action of the B.T.A., in dismissing Louisville's appeal while simultaneously deciding American's, was utterly meaningless except on the assumption that for the purpose of determining 1918 tax liability the two corporations are to be regarded as separate persons.

By dismissing Louisville's appeal, the B.T.A. said as plainly as it could that its decision was *not* intended to foreclose Louisville's rights. This ruling cannot reasonably be ignored as an empty technicality. For, although Louisville was a wholly-owned subsidiary of American, petitioner was *Louisville's* surety only—not American's. After the dismissal of Louisville's appeal, petitioner therefore had no standing to assist in the further proceedings. Indeed, as the Court of Claims found (Finding 29, R. 23), petitioner did not even learn of the B.T.A. decision until after it had been appealed to the Circuit Court of Appeals.

The Court of Claims has, however, ignored Louisville's absence from the B.T.A. case. In so doing, it has denied a hearing on the merits of Louisville's tax liability. Deprivation of property without a hearing is such a departure from the accepted and usual course of judicial proceedings as to call for an exercise of this Court's power of supervision.

2. The decision below conflicts with the decision of the Sixth Circuit Court of Appeals in *American Textile Woolen Co.* v. *Commissioner*, 68 F. (2d) 820 (1934), cert. denied 293 U.S. 558 (1934). In that case, which related to exactly the same factual situation as this one, the Sixth Circuit held that American had agreed to pay the entire consolidated tax. By the clear language of Section 240 of the 1918 Revenue Act, *supra*, the consolidated tax "shall * * * be assessed upon the respective affiliated corporations in such proportions as may be agreed upon among them * * *." The Sixth Circuit having held that American, by agreement with Louisville, had obligated itself for the whole tax, it has also necessarily held that Louisville was liable for no part of it. Yet the Court of Claims has held to the contrary.

It cannot be doubted that, if the present action had been brought in the Federal District Court at Louisville, the Sixth Circuit Court of Appeals would have adhered to its former ruling as to the existence and nature of the agreement between American and Louisville. A different result has been reached because the suit was brought in the Court of Claims instead. Decisions on questions of Federal law should not vary with the forum. This Court, in order to prevent such variations, grants certiorari to eliminate conflicts of decision and preserve uniformity in the rules of decision as applied in different parts of the Federal judiciary. The need for such review is here presented in

a particularly acute form, since there is not simply a conflict of principle, but an inconsistency between two decisions based on exactly the same facts.

Indeed, the petitioner contended below and contends here that the court below should have respected the Sixth Circuit's decision not only as a precedent, but as a determination binding on the Government under the rules of *res judicata*. The Government was a party to that case, and it is hard to see why it should not be bound by the decision even though Louisville, not being a party, was not. There is no requirement of mutuality in the application of *res judicata*. *American Law Institute, Restatement of Judgments,* Sec. 96, Comment a.

It should not be overlooked that the Government prevailed in the earlier case by proving the existence of the agreement between American and Louisville. Nothing would be more unconscionable than for the Government to collect a tax from Louisville which Louisville cannot owe if that agreement did exist. In this day of Government participation in virtually all fields of human affairs it is well to preserve the principle so well stated by Mr. Justice Holmes, that this Court will not suffer a Federal official to do a shabby thing.

3. The decision below conflicts in principle with *Noel* v. *Baskin,* 131 F. (2d) 231 (App. D. C. 1942). The Court of Appeals for the District of Columbia there held that a waiver of the statute of limitations *for an indefinite period* cannot arise by implication but must be "expressed in unequivocal terms." It also held that such a waiver, even if unequivocally made, should, "in the absence of specific language making it perpetual, * * * be held to operate only for a reasonable time." 131 F. (2d) at 232. In that case a reasonable time was held to be the same as the statutory period (computed from the date of the waiver).

In the present case, petitioner relied on Section 250 of the Revenue Act of 1918 and Section 277 of the Revenue Act of 1924, *supra,* which provide that collection proceedings must be initiated within five years after the return is filed. Louisville's separate return was filed March 15, 1919, and the five-year period for collection therefore expired March 15, 1924. Even if the limitation period were dated from American's consolidated return, which was filed February 12, 1921, the five-year period expired February 12, 1926. The suit to collect the tax here involved was not begun until August 12, 1936.

The Court of Claims rejected this contention on the ground that Louisville's surety bond, filed December 20, 1919, constituted a waiver of the statute of limitations. As will be seen from the terms of the bond, which is set forth in full in Finding 3 (R. 10-11), it contained no waiver for any specific period; indeed, it makes no reference whatever, in terms, to the statute of limitations. Under the rule of *Noel* v. *Baskin, supra,* it therefore cannot be read as a waiver for the indefinite future. The Court of Claims held, however, that it did operate as a permanent waiver—or at least that it was effective for the period of more than sixteen years which elapsed between the filing of the bond and the initiation of collection proceedings.

Moreover, even if the bond had contained an express waiver, it contained no "specific language making it perpetual." *Noel* v. *Baskin* holds that in such a case the waiver should be held to operate only for a reasonable time. The Court of Claims made no finding that sixteen years, eight months and twenty-three days was a reasonable time. Indeed, the record affords no basis for such a finding. The collection suit was not instituted until more than five years after the B. T. A. announced its decision on June 12,

1931, and over four and a half years after January 16, 1932, when its order was entered.

Surely there must be some time at which tax liabilities can be laid to rest. Under the theory of the decision below, the Government could have waited a full century or more before proceeding to collect. Granted that the sovereign can remain exempt from limitations if it so chooses, it has chosen not to do so in the field of taxation. The tax statutes announce a clear relinquishment of this ancient—and antiquated—sovereign prerogative. Unless this were so, the affairs of taxpayers could never be regarded as settled.

It may be noted that *Noel* v. *Baskin* goes farther than most of the authorities in upholding waivers of limitations statutes. In most jurisdictions permanent waiver, or waivers for an indefinite period, are held void as contrary to the public policy against litigation of stale demands. Annotation, 1 A.L.R. (2d) 1445, 1454 (1948). Some states even hold all waivers to be void, regardless of their duration. *Id.*, 1447. The ruling of the court below, in contravening even the very liberal Federal rule as expressed in the *Noel* case, not only results in a decisional conflict but presents an issue of great public importance in the administration of the income tax laws.

4. Another issue of considerable importance in the administration of the income tax laws is raised by the present case. Bluntly stated, the question is whether the officials of the Bureau of Internal Revenue, and indeed Federal officials in general, are to be held to the same legal standards of consistency and fair dealing which they are so quick to demand from private citizens.

There is no need, for present purposes, to inquire into the reasons which prompted the Commissioner to take the position that American had agreed to pay the taxes of its subsidiaries. Whether his determination to do so arose

from the fact that he thought American was more responsible financially, or (as seems likely) from the fact that he had allowed limitations to run on increasing the assessments of the subsidiaries, or from some circumstance not disclosed by the record, the unquestioned fact is that he did make a considered decision to that effect. Aided by the presumption which supports his findings, he was able to establish this position in the B.T.A. and the courts.

He then found that collection could not be made from American. We need not speculate as to whether this was because American had become insolvent, or whether (as seems likely) because the Commissioner made technical errors in the appeal to the B.T.A., or for some other reason. The plain fact is that, having discovered that the legal position he had established did not produce the dollars-and-cents result he wanted, the Commissioner then made a determination absolutely inconsistent with the agreement he had just proved to exist. It was on the basis of this determination that he rejected Louisville's claim for abatement. Such inconsistency by a taxpayer would draw the quick and justified criticism of the Commissioner.

Nevertheless the Government, because of the wording of the surety bond, was legally able to effect collection of the unpaid installment of Louisville's tax, with interest amounting to almost twice the unpaid tax itself. This was an act of power, not of right. Such collection was held by the courts to be authorized not because the tax was due, but because the tax liability could not be questioned in that proceeding.

Unless a hearing on the merits can be had in the present refund action, the Government—with full judicial approval—will have accomplished a result forbidden by the Fifth Amendment. No person can be deprived of property without due process of law, and due process includes the right to a hearing on the merits.

No one can doubt that the preservation of this principle is a matter of public importance. Its importance is particularly clear at the present time, when the Government—and particularly the Bureau of Internal Revenue—participates so deeply in our affairs. The very foundations of our society rest on the bed-rock proposition that public officials are not above the law.

Conclusion

The petition for a writ of certiorari should be granted.

Respectfully submitted,

ARTHUR W. GRAFTON,
CORNELIUS W. GRAFTON,
LOUIS LUSKY

CHARLES I. DAWSON,
Of Counsel